



ORGANISATION UNDOING TAX ABUSE



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OUTA's comments on the Draft Electricity Pricing Policy

**Submission to the Minister of Mineral
Resources and Energy**

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TABLE OF CONTENTS

1. INTRODUCTION	3
2. REFLECTION ON THE WHITE PAPER ON ENERGY	3
3. GENERAL OBSERVATIONS AND PRINCIPLED COMMENTS	5
4. DETAILED COMMENTS ON THE DEPP	10
<i>Definitions</i>	<i>10</i>
<i>Specific comments</i>	<i>11</i>
5. CONCLUSION.....	22

1. INTRODUCTION

- 1.1 By way of introduction, OUTA is a proudly South African non-profit civil action organisation, comprising of and supported by people who are passionate about improving the prosperity of our nation. We envision a prosperous country, with an organised, engaged, and empowered civil society that ensures responsible use of tax revenues.
- 1.2 Part and parcel to OUTA's mission is the challenging of legislation and regulatory environment, this includes participating and engaging with government on the Draft Electricity Pricing Policy ("DEPP") as published in the Government Gazette on 10 February 2022 (No. 45899). For clarity's sake, reference to "EPP" will refer to the Electricity Pricing Policy in its final form, prospectively.
- 1.3 OUTA welcomes the opportunity to submit comments on the DEPP. In the paragraphs below, OUTA will categorically illustrate its concerns, objections, and suggestions.

2. REFLECTION ON THE WHITE PAPER ON ENERGY

- 2.1. In reflecting on the need and desirability of such a policy, OUTA consulted the original White Paper on Energy of 1998. The objects of the White Paper were to ensure that energy was affordable, reliable, and sustainable. The second objective was to improve governance through increasing transparency and stakeholder engagement.
- 2.2. For contextual clarity, the relevant policy objectives are illustrated below.

Objective 1: Increasing access to affordable energy services

- 2.2.1. In pursuing this objective government acknowledges that the provision of energy services entails more than just the supply of fuels. Energy is only useful when it is affordable and sustainable, and when safe, easy-to-use, efficient appliances, consumer information and technical advice are available from service providers. In formulating policies affecting household energy services, government also acknowledges the central role played by women in utilising these services.

Objective 2: Improving energy governance

- 2.2.2. An important feature of the energy sector during the apartheid period was excessive secrecy, which made rational and public debate on energy policy nigh impossible. As a result of this history, governance within the energy sector suffers from a low level of accountability and transparency. Stakeholders will be consulted in the formulation and implementation of new energy policies, in order to ensure that policies are sympathetic to the needs of a wider range of stakeholder communities.

Objective 3: Stimulating Economic Development

- 2.2.3. Adjust electricity market structures to achieve effective forms of competition. To establish regulations which promote a cost-of-supply approach to electricity pricing for non-domestic consumers.

Objective 4: Managing energy-related environmental impacts

- 2.2.4. Investigate an environmental levy on energy sales to fund the development of renewable energy, energy efficiency and sustainable energy activities.

Objective 5: Securing supply through diversity

- 2.2.5. Utilise integrated resource planning methodologies to evaluate future energy supply options.

3. GENERAL OBSERVATIONS AND PRINCIPLED COMMENTS

- 3.1. Having regard to the above policy objectives and after reviewing the electricity pricing policy, OUTA provides the following broad principled comments, followed by detailed substantive comment below.
- 3.2. The DEPP is focused on cost recovery but with little acknowledgement that energy must be affordable. The DEPP itself is a complex document, seemingly written in a style that is appropriate for lawyers and industry experts. In our detailed comments, we have pointed out the drafting where definitions are not provided but readers are referred to other documents, or where grammatical errors are made. There appears to be some muddle over the numbering of the policy positions with duplicate numbers. This makes commenting on the DEPP quite difficult and more cumbersome than it should be.
- 3.3. It is difficult to see how ordinary South Africans could participate (and contribute) in such a complex document, yet it is every South African energy customer from those unable to afford to buy electricity currently, to those

running their swimming pools on electricity, who will experience the effect of the DEPP.

- 3.4. The White Paper addressed the need to manage energy related environmental impacts. The DEPP should therefore ensure that environmental externalities are included in the costing of electricity.
- 3.5. The DEPP speaks of a balance of social equity and financial viability. However, pricing policies must send the right pricing signals. Persistence to prop up outdated technologies or fail to include the full environmental externalities could continue to promote expensive electricity. The DEPP must send the pricing signals that would result in shutting down old power stations that are unaffordable to run and ensure that new generation is procured at a price that would stabilise energy prices in the medium to long term.
- 3.6. The EPP needs to avoid situations like Karpowership where government proposed to lock in a 20-year contract subjected to the international commodity price of gas and the US dollar/rand exchange. The EPP must avoid such contracts by for example, not allowing long term contract prices to rise beyond inflation.
- 3.7. OUTA does not support measure to try and curtail those who have taken the steps to install additional generation. However, such customers may provide valuable back up to the grid, feeding in power. Moreover, with the correct pricing policies, such customers can become valuable components of the electricity system.

- 3.8. Attempts to use the EPP to “penalise” such customers for taking on the supply of electricity to keep their business going (while Eskom’s failure to do so), will only drive such customers off grid entirely. Such an off-grid option is becoming more and more desirable as storage options become more affordable.
- 3.9. The EPP provides a raft of ancillary and additional charges, but OUTA would argue that the charges must be transparently unpacked. In addition, the system operator is required to keep the lights on 24/7. Such costs as stand by power, or any other back up or balancing power generation must be the responsibility of the system operator who must ensure that there is sufficient generation available that can be procured at the time needed. Generators that are variable in nature or have fixed time periods of down time for refuelling or maintenance would schedule such outages into their Power Purchase Agreements (“PPAs”). The system operator then plans for a diverse range of energy generators, operating on the principle of most affordable first.
- 3.10. The Risk Mitigation Independent Power Producers Procurement Programme (“RMIPPPP”) has shown the folly of insisting that each generator be able to operate in a dispatchable manner. The costs of generation are much higher as each generator is separately expected to provide backup generation which then lies idle until needed. The necessity of including such costs in the individual generators obviously pushes the price of generation up, unnecessarily.
- 3.11. The principle of non-discrimination is supported. This should apply to rural/urban divides as well as generators that are geographically distant from their markets. The system operator and the office responsible for energy planning must establish which resources should be used for electricity

generation and the grid should be strengthened accordingly. Such expenses should then be borne by the national consumer base, as part of ensuring security of supply.

- 3.12. The costs of the grid should be allocated to the generators and included in the cost of the electricity that is supplied to consumers. The wheeling costs would include all of the various system costs that have been discussed before.
- 3.13. There are a number of statements on tariffs which seem to be orientated towards the investor or generator profiting rather than the provision of energy as an affordable and reliable service to drive economic development. These statements appear in different sections. We have commented on the principle in one section and such comments would then apply to all other sections where similar sentiments are expressed.
- 3.14. Some of these statements appear to allow for Eskom and the distribution system to retain its current tariff structure and appear to counter some of the earlier statements on non-discrimination, etc. Some of the policy statements, particularly at the distribution level appear aimed at recovery of revenue at the expense of providing security of supply and the idea of prosumers and those with own generators supporting the grid at a local level appears to be penalised rather than welcomed.
- 3.15. One example of this is reflected in policy position 33 which proposes that customers that feed back into the grid be charged an additional charge to cover the cost of the billing. This once again appears to be an attempt to penalise rather than incentivise a new system and given that billing should be

computerised, such a proposed charge can only be construed as discrimination.

- 3.16. The positions on subsidies do not appear to be innovative, and we submit that a fresh approach is needed. The costs of off grid or mini-grid supply for customers who are currently subscribed to Free Basic Electricity (“FBE”) or lifeline tariffs should be considered. It might be less expensive to supply such households with an equivalent amount of assets i.e., a solar water heater, solar panel and gas or gel cooker. These would then allow such consumers to have energy security without incurring energy charges that they cannot afford, leaving such households to utilise that money for food.
- 3.17. Demand side flexible options should form part of the EPP. Energy efficiency should be a goal and should be incentivised through the tariffs. Furthermore, the EPP needs to adopt a more participatory approach to its tariff setting, particularly to educate all levels of consumers and to ensure that all South Africans can understand and contribute to an efficient and effective tariff structure that enable energy to be a driver for economic development.
- 3.18. In conclusion, the Department of Mineral Resources and Energy (“DMRE”) needs to reissue this DEPP for public comment but embark on a roadshow and ensure that the updated EPP contains more up to date references and is geared towards a futuristic energy system rather than one that seems rather conservative.
- 3.19. Note that OUTA is amenable to engage with any representative of the DMRE to elaborate on any comments made in this submission.

4. DETAILED COMMENTS ON THE DEPP

Definitions

- 4.1. *“IEP”* – This should be “Integrated Energy Plan” and not “Integrated Energy Planning”.
- 4.2. *“Flexible Distribution Services”* – We submit that this should not be part of the general distribution system.
- 4.3. *“Legacy Costs/contract”* – There should be a differentiation between “costs” and “contracts”. Such legacy costs should refer to past costs not future costs. Any new build, whether Eskom or outside of Eskom cannot be referred to as legacy projects.
- 4.4. *“Net Billing”* – More clarity is required. This is a costing system where a customer will be credited for their generation and feeding into grid. The ability to generate energy or electricity and feed into the grid is separate to the billing system associated with such activity. The definition is confusing as it conflates the energy and pricing issues.
- 4.5. *“Retail”* – Retail refers to the business of selling something (i.e. electricity). *“The function related to the supply of electricity and network services”* does not relate to retail business in our view.
- 4.6. *“Resellers”* – In our view, this definition is that of retailers.

- 4.7. *“Replacement costs”* – The definition includes the time period of one year. The replacement costs for generation or other parts of the system would necessarily be spread over a number of years. The total replacement costs would include the total of all the infrastructure costs. This might be depreciated over a 20- or 30-year period giving an annual cost, but the definition is not clear.
- 4.8. *“Single buyer”* – In our view, the single buyer is part of the state-owned transmission and system operator. A single buyer is therefore to buy on behalf of the state, not industry.
- 4.9. *“Stand by charges”* – This needs greater clarity. Surely the system would be set up so that stand by generation would be available and charge a particular price when needed. It is unclear why such charges need a separate category.
- 4.10. *“Trader”* – This definition seems to align with what we would regard as a retailer.
- 4.11. *“Transmission”* – This definition cannot be defined according to another document. If this DEPP is to use a definition found in another document, the definition must be cut and pasted into this document for universal application.
- 4.12. *“Wheeling”* – Wheeling should apply to all parties and not just a utility supplier. The word “utility” should be removed.

Specific comments

- 4.13. *Pg 18* – It seems that the word “market” has been omitted in error. However, the larger principle of balancing economic growth with environmental goals cannot be supported. Economic development must place people and the

environment they depend on at the forefront. The recent groundwork court case where Eskom has been ordered to clean up its air pollution is a case in point. Concentration on short term economic gains has led to severe environmental pollution in Mpumalanga. If such costs had been included from the beginning of the lifespans of the power stations, it is possible that Eskom might have chosen technologies that were more affordable and less damaging to people's health and environment.

- 4.14. *Pg 19* – OUTA agrees that the electricity system must be financially viable.
- 4.15. *Pg 19, 1.3. j.* – It would be preferable to state the problem as “the lack of clarity in the trading of electricity...” rather than “how trading of electricity.”, as this would align better with the rest of the paragraphs.
- 4.16. *Pg 21, 1.5.* – OUTA would agree that there is a need for a new White paper on energy. To rely on a policy that was formulated in 1990's when the electricity sector has undergone such technological advances, poses the risk that South Africa would be locked into an unsustainable and unaffordable electricity system.
- 4.17. *Pg 22* – OUTA would point out that the current death spiral and the emergence of “partial self-generation” options is a direct response to the unreliability of Eskom and the out-of-control spiralling costs of Eskom and municipal electricity.
- 4.18. *Pg 25, 2.1* – A key principle which is missing is the necessity to provide affordable electricity for all. The recent years have seen how Eskom has used

the Regulatory Clearing Account (“RCA”) mechanism to continue to raise its tariffs to recover costs without any apparent consideration of the ability to pay.

- 4.19. Pg 26 – OUTA supports the principle that people should pay according to their use. This needs to deal with the balance of maintaining the grid and ensuring that low electricity users do not pay disproportionate costs for their fixed costs component of the tariff.

4.19.1. We would support an approach which sees customers pay a proportion of their fixed costs dependent on their usage. I.e., If a customer uses the grid for 4 hours a day, the fixed costs component of the tariff must reflect the percentage of time they used the grid.

4.19.2. The use of time of use tariffs would also deal with the evening peaks. If Residential customers paid more for evening peaks, they would become more efficient, shifting the load and reducing their peak usage. This would benefit the system.

- 4.20. Pg 26, 2.2 – OUTA agrees strongly that electricity prices should reflect prudent and efficient costs. State support should be minimal but state regulation in order to assess the tariff applications for prudence and efficiency is a mandatory requirement.

- 4.21. Pg 32, *Policy Position 1* – While attracting investment and ensuring that business do earn some return is important, there is a need to acknowledge that the market does not provide for the poor and that a captive market where customers have no options but to pay exorbitant prices for electricity or to live

without electricity undermines the fundamental goal of the electricity system – that of providing electricity as a driver for economic development for all. This is the current Eskom-dominated system, and any restructuring of the electricity system must acknowledge and include price elasticity in its EPP.

4.22. *Pg 33, Policy Position 2* – OUTA agrees that tariffs should reflect the efficient costs of providing electricity services. It is not totally clear how this would be achieved in detail, but we would submit that the capacity costs must be spread across the system. The systems operator needs to ensure that there is always sufficient generation available in the system and must procure necessary generation. Those variable generators should not themselves be liable for additional capacity to supply the grid when they are not contracted to deliver. This is the responsibility of the system operator to find the most affordable generator to fill the gap. This is similar to how Eskom operates at the moment. If Koeberg is down for planned refuelling, the costs of supplying the additional capacity to the grid is not laid at Koeberg's door but is borne by the system. In this case, Eskom, who then needs to run the diesel peakers more often. The cost is borne by the system and ultimately passed on to the customers. If there was a more affordable generator available than the diesel peakers, for example, storage options or additional pumped storage, then that should be contracted first. This is an obvious principle as no generator runs 24/7 and 365 days a year but it is not clear from the DEPP.

4.23. *Pg 33, 2.4* – OUTA supports complete transparency. There is a concern about the words “*where practical*” which appears to be an excuse not to implement full transparency. We suggest that these words be removed.

- 4.23.1. Where the equipment is not available to enable full transparency at the customer level, a timeframe should be put into the policy – for example, 5 years, to ensure that good governance is implemented.
- 4.23.2. In addition, performance information as well as the costs of keeping the system stable should be available in real time. For example, if the system operator is forced to use more expensive generation options due to breakdowns of power stations, then this information should be available to customers in real time. This will alert customers to possible future tariff increases and with the implementation of time of use tariffs, would enable customers to respond in real time. If customers can reduce the load at critical times through rapid pricing signals, this would enable the system operator to potentially minimise unexpected price spikes due to unplanned outages.
- 4.24. Pg 34, Policy Position 3 – One cannot have a policy position that refers to a unknown document that is not provided. The principle of non-discrimination is supported provided it is balanced with the need for cross subsidies or the provision of alternative electricity systems where necessary. For example, if a similar cost-effective service of electricity supply can be provided through an off-grid or mini-grid solution rather than the extension of the grid, this would be supported.
- 4.25. *Pg 34, Policy Position 4* – OUTA supports the removal of discriminatory practices particularly those that discriminate against the poor or that favour older established generators.

- 4.26. *Pg 35, 2.6* – Wheeling should be allowed through the grid irrespective of the supplier of power. The caveat on the need to pay all relevant charges should be that such charges may not increase beyond the price of inflation each year, or in exceptional circumstances, a 15% deviation from inflation might be allowed.
- 4.27. *Pg 35* – The Southern African Power Pool (“SAPP”) rules have not been provided. It is therefore impossible for the public to comment.
- 4.28. *Pg 35, Policy Position 5* – The position that there should be fair and non-discriminatory access to all networks is supported. There should also be a specific reference to affordable charges in all paragraphs where full costs and system charges are mentioned.
- 4.29. *Pg 36, 2.7* – Real time pricing as well as time of use tariffs should be implemented as part of the normal pricing structure not as a special product.
- 4.29.1. There should also be a rate that customers are refunded should their power supply be interrupted. In other words, generators should be incentivised to keep the lights on, rather than paid whether there is power or not, as currently observed.
- 4.29.2. Customers should be entitled to not only a refund on a portion of their energy costs but also a refund on the proportion of their fixed costs should there be a power supply interruption. Technological advances enable the system operator to track and calculate such losses through smart billing systems.

- 4.30. *Pg 37, Policy Position 6* – There is some concern about the rapid tariff approval processes. While some flexibility might be required in the system, this should always ensure that public participation is not compromised.
- 4.31. *Pg 37, 2.8* – OUTA supports long term price stability.
- 4.32. *Pg 37, Policy Position 7* – The annual publication of a multiyear price path is supported. The idea that this price path should cover at least 10 years forward is appreciated although with rapid advances in the electricity system worldwide, it might not be that easy to achieve.
- 4.33. *Pg 38, 3.0 e.* – This section is broadly supported. However, section e speaks to the market operator which would operate the trade between different players but owns nothing and something called “Transmission” that takes ownership of legacy contracts and sells this energy. We submit that this is confusing. Surely transmission is the infrastructure and institution that is a state entity that owns the transmission grid but does not trade. It simply wheels as and when needed. The legacy contracts owned by Eskom generation or IPPs should simply sell their energy into the grid through the market operator. This market operator would have special contracts with legacy projects which might make force some of these generators onto the grid even if they are not the cheapest generation at the time.
- 4.33.1. On page 47, it appears that the above section might be badly drafted. It appears that there will be a central purchasing agency which will sell its legacy project energy into the grid.

- 4.34. *Pg 39, Figure 2* – This diagram refers to the interfaces between customers and generations, transmission, and distribution. However, the system is presented as a one-way system from generator to customer. This is an outdated presentation and needs to be amended to reflect the two-way metering, net billing, and prosumers.
- 4.35. *Pg 42, Policy Position 9* – This is supported broadly, and generators must bear the full costs of generation including environmental externalities. Generators should not bear the cost of their planned availability – as this is a cost to the system as outlined earlier in this submission.
- 4.36. *Pg 43: Policy Position 10* – OUTA would reiterate that expedited frameworks must still ensure that meaningful public participation takes place.
- 4.37. *Pg 43, 5.1* – OUTA reiterates its position as outlined above – generators are contracted to deliver for certain time periods and the system operator must ensure that adequate supply is purchased. This charge should not fall on the individual generators as this would discriminate against reliable but variable electricity generators, probably incentivise insufficient downtime for maintenance and generally push the price of electricity up. This can be seen in the prices proposed for the RMEIPP.
- 4.38. *Pg 44, Policy Position 11* – All environmental externalities including water provision, air pollution, water pollution, as well as climate related levies and taxes must be included. Decommissioning and waste disposal costs must be kept in a separate fund that is not just a balance sheet accounting trick.

- 4.39. *Pg 48, Policy Position 12* – There is a proposal that the National Energy Regulator of South Africa (“NERSA”) develop a dynamic over/under recovery mechanism to deal with mismatches between legacy energy purchases and sales. This sounds very much like the continuation of the RCA, and we reject this proposal. If legacy costs spiral out of control, as the coal fleet does now, then those generators must absorb those costs, plan better or go out of business. It cannot be that the customer base continues to be held to ransom for non-viable power stations.
- 4.40. *Pg 49, 5.2* – Such pricing agreements should not be necessary if proper contracting is carried out. Negotiated Pricing Agreements (“NPAs”) that relate to international commodity prices should only be allowed to vary by a minimum deviation related to inflation plus a small additional deviation, if allowed at all. Existing NPAs should be open to renegotiation should it appear that excessive profits are being generated due to their existence.
- 4.41. *Pg 52* – There is a need for transparency as outlined earlier. From a customer’s perspective, there should not be charges unless the need and exact details can be transparently motivated. This applies to stand by charges. These charges appear to be additional charges added without real motivation. As we have stated before, it is the system operator who must guarantee reliable affordable electricity and incur the costs to do so. Such costs, if reasonable and prudent, would then be part of the costs that accrue to customers.
- 4.42. *Pg 67, Policy Position 18* – Rather than continuing with an inequitable system, OUTA would suggest that such a system be phased out in the next 3 years.

- 4.43. *Pg 72, Policy Position 22 – “NERSA shall develop a national tariff framework to guide how tariffs are structured while recognising need for innovation in development and the approval of updates to tariff structures.”* We contend that this statement is superfluous as it supposes what the EPP is all about. If anything, a statement that NERSA shall update its tariffs according to the policy might be appropriate, although it does appear to be stating the obvious.
- 4.44. *Pg 72, 8.1 –* There is reference to the cost of supply. This seems currently to be a black box and there is a danger that distributors and transmission would inflate their “cost of supply”, which is not transparently provided, in order to offset any potential revenue losses that might occur when the new pricing policy is implemented.
- 4.45. *Pg 73, Policy Position 24 –* Cost of supply studies must precede any applications to the regulator for a change to tariff structures. Once NERSA and the applicant are then in agreement on the cost of supply, then such an applicant could apply for tariff increase.
- 4.46. *Pg 74 –* Backlogs in distribution are covered by the ADAM Programme and should not need to be included in tariff structures here.
- 4.47. *Pg 74, Policy Position 25 –* Nontechnical losses and bad debt are not the system operator or the customer’s responsibility, costs should not be included in the tariffs.
- 4.48. *Pg 94, Policy Position 37 –* OUTA supports the position that streetlights are considered electricity consumers and should not be included in electricity

supply. The municipality financing system needs an overhaul, and it should no longer be possible for municipalities to add levies onto electricity tariffs to subsidise other services.

- 4.49. *Pg 98, Policy Position 42* – The DEPP proposes that schools, hospitals, etc. should pay full price for electricity. This is appropriate providing that advisory support can be provided to encourage energy efficiency and load reduction. Such measures could include solar water heaters, additional insulation, etc.
- 4.50. *Pg 100, Policy Position 42* – OUTA fully supports this position. This would incentivise distributors to ensure that there is security of supply and adequate maintenance. Such a system of penalties for lack of delivery should be applied at transmission level as well as distribution level.
- 4.51. *Pg 100, Policy Position 43* – This policy position relates to the resellers. OUTA has found this system to be severely compromised with many consumers paying far above the municipal rate. Part of the problem is consumer ignorance coupled with inadequate compliance monitoring. It is not clear how this helps with this issue as the NERSA policy simply repeats the *status quo*.
- 4.52. *Pg 113* – Distortion in electricity tariffs have caused undesirable patterns of behaviour. OUTA would agree that this has resulted in a general wastage of electricity, and space heating and cooking are done with electricity rather than alternatives. However, the advent of induction stoves and the rapidly rising price of electricity have probably changed these patterns of behaviour in recent times. There is a need for studies to confirm or review the distortions and behavioural patterns outlined in this section.

- 4.53. *Pg 116, 10.21* – In times of power shortages which South Africa now faces, NERSA proposes some price signals that would penalise those that didn't save and exacerbated the economy wide costs of unserved energy, currently borne by those that experience the interrupted energy supply. OUTA feels that such innovative ideas could play a role in ensuring energy efficiency.
- 4.54. *Pg 117* – Funds for such interventions could be in the form of loans to be paid back over time via the energy savings that are made.
- 4.55. *Pg 121* – This is concerning that the most recent reference in the bibliography is 13 years old. OUTA would urge the policy makers to apply their minds and conduct some research into how some of these questions have been addressed internationally, based on more recent data and best practice.

5. CONCLUSION

- 5.1. We trust the favourable consideration would be given to OUTA's concerns and propositions as outlined in this submission. We also remain amenable to any further stakeholder engagements relating to the EPP.